

For release on delivery  
10:00 a.m. EDT  
June 4, 2003

Statement of  
Dolores S. Smith  
Director, Division of Consumer and Community Affairs  
Board of Governors of the Federal Reserve System  
before the  
Subcommittee on Financial Institutions and Consumer Credit  
of the  
Committee on Financial Services  
U.S. House of Representatives

June 4, 2003

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to testify before this Subcommittee on the role of federal banking regulators under the Fair Credit Reporting Act (“FCRA”) and on how the FCRA promotes the national operations of entities under our jurisdiction. I commend the Subcommittee for holding this hearing to gather information and solicit the views of interested parties concerning this important topic.

## **I. The Fair Credit Reporting Act**

### **A. Background**

When Chairman Greenspan testified before the House Financial Services Committee earlier this year, he noted that there was a time in this country when local banking institutions knew the credit capacity of the individual consumers in their community. As the financial system became larger and more complex and the mobility of the population increased, particularly after World War II, it was no longer feasible for institutions to evaluate the credit standing of consumers on a strictly local basis. Centralized credit bureaus, or consumer reporting agencies, evolved to provide a repository of credit history information that could be accessed by creditors to evaluate the creditworthiness of prospective borrowers. The credit reporting system has had, as Chairman Greenspan put it, “a dramatic impact . . . on consumers and households and their access to credit in this country at reasonable rates.”<sup>1</sup>

Today, each of the three national consumer reporting agencies--Experian, Equifax, and Trans Union--maintains records on as many as 1.5 billion credit accounts held by approximately

---

<sup>1</sup> Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, February 12, 2003, House Financial Services Committee; see also Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, April 30, 2003, House Financial Services Committee.

190 million individuals. Each of the consumer reporting agencies receives more than 2 billion items of information per month and issues roughly 2 million credit reports each day.<sup>2</sup>

The information gathered by the consumer reporting agencies is obtained from banks, savings associations, credit unions, finance companies, retailers and other creditors, collection agencies, and public records. A consumer report generally consists of five types of information: identifying information, such as the consumer's name and address; detailed information reported by creditors regarding individual credit accounts; public record information, such as records of bankruptcies, foreclosures, and tax liens; information reported by collection agencies, mostly regarding non-credit related accounts; and information regarding inquiries about a consumer's credit record. Consumer reports are used for credit, insurance, employment, and certain other limited purposes.

## **B. Overview of the FCRA**

The Congress adopted the FCRA in 1970 to regulate the credit reporting system in the United States, and passed significant amendments in 1996. The primary purposes of the FCRA are to ensure fair and accurate credit reporting and to protect consumers' privacy. Among other things, the FCRA imposes certain obligations on consumer reporting agencies, on users of consumer reports, and, since 1996, on furnishers of information.

The major provisions of the FCRA are as follows. Under the FCRA, a person may obtain a consumer report only if that person has a permissible purpose. The statute specifies the permissible purposes for obtaining a consumer report, which include the intended use of the information from a consumer report for a transaction involving an extension of credit to a consumer. If a creditor takes any action that is adverse to a consumer based on information in a

---

<sup>2</sup> See "An Overview of Consumer Data and Credit Reporting," Federal Reserve Bulletin, February 2003, at 49-50.

consumer report, the creditor generally must give the consumer a notice of the adverse action. This notice informs consumers about their rights under the FCRA.

Participation in the U.S. credit reporting system is voluntary. Creditors are not required to obtain consumer reports before making credit decisions, although most creditors rely on consumer reports for risk-management purposes. There also is no requirement that creditors furnish information to consumer reporting agencies. But if they do, they must ensure that the information they furnish is accurate. They must correct and update erroneous information, and must investigate any disputed information.

Consumer reporting agencies have extensive responsibilities under the FCRA. Those responsibilities include: maintaining reasonable procedures to ensure that consumer reports are furnished only to persons having a permissible purpose; following reasonable procedures to ensure the maximum possible accuracy of consumer reports; reinvestigating the accuracy or completeness of any disputed information and notifying the consumer of the results of the reinvestigation; omitting certain obsolete information from consumer reports after specified periods of time; and providing a consumer with a copy of his or her consumer report upon request.

### **C. Consumer Protection under the FCRA**

The FCRA contains important consumer rights and protections. Several are designed to promote accuracy in consumer reports. As mentioned above, a consumer must receive notice if information in a consumer report has resulted in adverse action against the consumer. An adverse action notice must inform the consumer of the name, address, and telephone number of the consumer reporting agency that furnished the report, the consumer's right to obtain a free copy of the consumer report, and the consumer's right to dispute the accuracy or completeness of

any information in the consumer report. Consumers have a right to obtain a copy of their consumer reports, except for credit scores, upon request.<sup>3</sup> Consumers also have the right to dispute the accuracy or completeness of any information in their consumer reports with a consumer reporting agency, to have such information deleted or corrected, and to include a statement of dispute in the report if the dispute is not resolved. Consumers may also dispute inaccurate items with the furnisher of the information.

Other consumer rights and protections are designed to protect consumer privacy. Consumers have a right to be excluded from prescreened solicitation lists. The three national consumer reporting agencies maintain a toll-free telephone number that consumers can call to exercise what is, in effect, a right to opt out of receiving most prescreened solicitations for a period of two years. Consumer privacy is also protected by the limitation on access to consumer reports to persons that have certified a permissible purpose under the FCRA. In general, the FCRA restricts the sharing of certain information among affiliates unless the consumer is given the opportunity to opt out of that sharing. Additional privacy protections cover specific circumstances where consumer reports are provided to prospective employers, consumer reports contain medical information, or investigative consumer reports are prepared or obtained.

#### **D. The Role of the Federal Reserve Board Under the FCRA**

The Federal Reserve Board and the other banking agencies play an important role in interpreting and enforcing the FCRA as it relates to credit. The agencies have the statutory authority to jointly prescribe regulations necessary to carry out the purposes of the FCRA with respect to financial institutions subject to their jurisdiction. The Board also has authority to prescribe regulations (consistent with the interagency regulations) with respect to bank holding

---

<sup>3</sup> A credit score is a numerical representation of a consumer's overall credit profile.

companies and their affiliates (other than depository institutions and consumer reporting agencies).

The FCRA specifically authorizes the Board to enforce compliance with the Act with respect to state member banks, branches and agencies of foreign banks (other than federal branches, federal agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under sections 25 or 25A of the Federal Reserve Act. The Board has adopted examination procedures for entities subject to its jurisdiction and routinely examines for compliance with the FCRA. The other banking agencies have substantially similar examination procedures for entities subject to their jurisdiction.

The entities subject to the Board's jurisdiction primarily are users of consumer reports and furnishers of information. Typically, entities regulated by the Federal Reserve Board are not consumer reporting agencies.

#### **E. Preemption under the FCRA**

In the 1996 amendments to the FCRA, the Congress preempted the states from enacting laws or regulations dealing with seven key areas regulated by the FCRA:

- The procedures for furnishing information from consumer reports for the purpose of offering credit through prescreened solicitations, such as the procedures through which consumers may elect to have their names and addresses excluded from any prescreened list;
- The time for completing reinvestigations of disputed consumer report information;
- The duties of creditors that take adverse action, such as the duty to give the consumer notice of the adverse action and the consumer's rights under the FCRA;

- The informational contents of consumer reports, such as the time periods within which consumer reporting agencies must omit from consumer reports certain obsolete information;
- The duties of furnishers of information, such as the duty to investigate the accuracy and completeness of information furnished to a consumer reporting agency upon receipt of notice from the consumer reporting agency that the information is disputed;
- The rules regarding the sharing of information among affiliated companies, such as when a consumer may have the opportunity to opt out of certain information sharing among affiliates; and
- The form and content of the written disclosure summarizing the consumer's rights under the FCRA that consumer reporting agencies must provide to consumers along with a copy of the consumer's credit report.

These preemption provisions are scheduled to sunset on January 1, 2004. After that date, states would be permitted to enact laws in these seven areas if those laws explicitly provide that they are intended to supplement the FCRA and give greater protection to consumers than is provided under the FCRA.

Preemption under the FCRA is limited to these seven areas, and states are not precluded from enacting supplementary laws or regulations in other subject areas addressed by the FCRA. Some states have enacted laws requiring consumer reporting agencies to provide free copies of credit reports to consumers annually, even though the FCRA only requires free copies after adverse action has been taken based on information in a consumer report. Some states also require consumer reporting agencies to disclose credit scores to consumers, even though the FCRA does not require the disclosure of credit scores.

The Chairman has stated that he would support making permanent the provision currently in the FCRA “that provides for uniform federal rules governing various matters covered by the FCRA.”<sup>4</sup> In an appearance before the House Financial Services Committee in April of this year, Chairman Greenspan spoke of the importance of having “national standards” under the FCRA.<sup>5</sup>

## **II. Discussion of the National Credit Reporting System**

### **A. The FCRA and the Nationwide Operations of Financial Institutions**

The FCRA promotes the interstate operations of banks and other financial entities subject to the Board’s jurisdiction in important ways. Perhaps most significantly, the ability of financial institutions to obtain standardized consumer reports--that contain robust, nationally uniform data--allows banks to make prudent credit decisions quickly and inexpensively wherever they do business and wherever their customers live and work. The FCRA’s national standards governing furnisher responsibilities and duties of users taking adverse action--the two primary areas of responsibility for most financial institutions--promote efficiency by enabling banks to comply with a single set of rules for all of their domestic credit operations.

The FCRA’s provisions regarding firm offers of credit or prescreened solicitations have enabled banks to effectively market their products to consumers most likely to want them. Without prescreened solicitations, the cost of acquiring new customers, particularly in the credit card market, could be considerably higher. The FCRA’s affiliate-information sharing provisions enable bank holding companies and other large financial enterprises to efficiently manage and use consumer information across multiple account relationships.

---

<sup>4</sup> Letter from Chairman Alan Greenspan to Congressman Rubén Hinojosa, February 28, 2003.

<sup>5</sup> Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, April 30, 2003, House Financial Services Committee.



## **B. The FCRA and the National Credit Reporting System**

On the question of whether the preemption provisions of the FCRA should be extended or made permanent, today's hearing offers Subcommittee members an opportunity to obtain input from various interested parties and to assess the likely impact that state-by-state differences in the seven areas could have on the national credit reporting system and the credit granting process. A key consideration in this reexamination of federal preemption of state law is the impact that different state laws may have on the availability and cost of consumer credit.

Maintaining a reliable and robust national credit reporting system is essential to ensure the continued availability of consumer credit at reasonable costs. As Chairman Greenspan observed, "there is just no question that unless we have some major sophisticated system of credit evaluation continuously updated, we will have very great difficulty in maintaining the level of consumer credit currently available because clearly, without the information that comes from various credit bureaus and other sources, lenders would have to impose an additional risk premium because of the uncertainty before they make such loans or may, indeed, choose not to make those loans at all."<sup>6</sup>

The ready availability of accurate, up-to-date credit information from consumer reporting agencies benefits both creditors and consumers. Information from consumer reports gives creditors the ability to make credit decisions quickly and in a fair, safe and sound, and cost-effective manner. Consumers benefit from access to credit from different sources, vigorous competition among creditors, quick decisions on credit applications, and reasonable costs for credit.

---

<sup>6</sup> Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, April 30, 2003, House Financial Services Committee.

State-specific restrictions governing areas such as furnishing information to consumer reporting agencies, or the contents of information contained in consumer reports supplied by consumer reporting agencies, could decrease the availability of credit or increase the cost of credit. As Chairman Greenspan observed, “[l]imits on the flow of information among financial market participants, or increased costs resulting from restrictions that differ based on geography, may lead to an increase in the price or a reduction in the availability of credit[.]”<sup>7</sup>

Additionally, credit scoring has become an important tool in the credit granting process. Credit scoring models use credit bureau data to construct mathematical scorecards that accurately predict the risk profiles of individual consumers. The predictive power of credit scores depends directly on the content and quality of the credit bureau data that are used to construct the models. Credit scoring enables creditors to evaluate, quickly and inexpensively, the risk of lending to virtually any credit applicant, and promotes the making of expedited credit decisions in a safe and sound manner. Consumers benefit from the increased availability and lower cost of credit that results from the use of credit scoring models. Credit scoring also may help to reduce unlawful discrimination in lending to the extent that these systems are designed to evaluate all applicants objectively and thus avoid issues of disparate treatment. As Chairman Greenspan recently noted, “the emergence of credit scoring technologies, which rely on the availability of information about the financial experiences of individuals, has proven useful in expanding access to credit for us all, including for lower-income populations and others who have traditionally had difficulty obtaining credit. It has also enabled financial institutions to offer a wide variety of customized insurance, credit and other products.”<sup>8</sup>

---

<sup>7</sup> Remarks following prepared testimony by Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, April 30, 2003, House Financial Services Committee.

<sup>8</sup> Letter from Chairman Alan Greenspan to Congressman Rubén Hinojosa, February 28, 2003.

Non-uniform state laws currently preempted by the FCRA might seek to restrict the information that can be furnished to or reported by a consumer reporting agency and could reduce the availability or increase the cost of credit by impairing the utility of consumer reports and credit scores that creditors use for portfolio management, underwriting, and fraud control. Legislation has been proposed in several states to impose greater obligations on furnishers to ensure the accuracy of information furnished to consumer reporting agencies.

The duties of furnishers of information raise complex issues that require a delicate balancing of divergent interests. The accuracy of consumer report information is a critical element of the national credit reporting system. Recent studies have shown that consumer reports sometimes contain inaccurate, incomplete, or inconsistent data, although the degree to which this is a problem is in dispute.<sup>9</sup> Most of the problems with consumer reporting agency data appear to result from the failure of creditors, collection agencies or public entities to furnish complete and consistent information in a timely manner.<sup>10</sup>

Although these studies might suggest to some that states should be allowed to impose increased obligations on furnishers to ensure the accuracy of the information that they furnish, differing state laws regarding the duties of furnishers could have adverse consequences. First, state-by-state differences in the responsibilities of furnishers--many of which operate nationwide--could result in consumer reporting agencies obtaining less complete and consistent data and increase compliance costs for furnishers. Second, because there is no requirement to furnish information to consumer reporting agencies, the imposition of additional, state-specific

---

<sup>9</sup> For a summary of these recent studies, see “An Overview of Consumer Data and Credit Reporting,” Federal Reserve Bulletin, February 2003, at 50.

<sup>10</sup> Id. at 70-73.

duties or liabilities on furnishers for purposes of ensuring accuracy could affect the willingness of creditors to furnish information voluntarily to consumer reporting agencies.

The informational content of consumer reports, including the requirement to remove obsolete information, is another area where different state laws could adversely affect the national operations of banks and bank holding companies. Under the FCRA, consumer reporting agencies generally may include any information in a consumer report, except that certain obsolete information must be omitted from consumer reports within prescribed time periods. If the preemption provision applicable to the informational content of consumer reports is allowed to sunset and states were to enact different restrictions on what information, if any, must be omitted from consumer reports--and when--the contents of consumer reports could vary on a state-by-state basis. This would make it more difficult and costly for institutions doing business in different states to evaluate the creditworthiness of prospective applicants.

Different state law requirements regarding furnishers or the informational contents of consumer reports, therefore, could produce a lack of uniformity in credit bureau data and undermine the utility of such data for assessing creditworthiness. This, in turn, could compromise the integrity and predictability of the credit scoring models that banks and other creditors rely upon for risk-based underwriting and portfolio management. As a consequence, creditors might have greater difficulty assessing their risk from an underwriting, portfolio management, and fraud control perspective, which could lead to higher credit costs and reduced credit availability.

### **III. Conclusion**

In conclusion, this Subcommittee is to be commended for undertaking this examination of the FCRA preemption provisions to determine whether to allow states to enact non-uniform

laws or regulations in areas currently preempted by the FCRA. In conducting this examination, it is important to ensure that we maintain a viable, national credit reporting system that preserves and expands reasonable access to credit.